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**[C-42/19 Sonaecom](http://curia.europa.eu/juris/documents.jsf?oqp=&for=&mat=or&lgrec=en&jge=&td=%3BALL&jur=C%2CT%2CF&num=C-42%252F19&page=1&dates=&pcs=Oor&lg=&pro=&nat=or&cit=none%252CC%252CCJ%252CR%252C2008E%252C%252C%252C%252C%252C%252C%252C%252C%252C%252Ctrue%252Cfalse%252Cfalse&language=en&avg=&cid=8908924" \t "_blank)**

On 12 November 2020 the CJEU released its decision in this Portuguese referral asking whether VAT can be recovered on advisory fees attributable to market research for the purpose of acquiring shares where the acquisition does not actually take place? Can VAT be recovered on costs incurred in organising a bond loan, taken out with a view to integrating the financial structure of affiliated companies, and which, since those investments failed to materialise, was ultimately transferred to the parent company of the group?

Sonaecom is a holding company which acquires, holds and manages shares with full rights to the resulting income. In addition, it manages and provides strategic coordination to companies operating in the telecommunications, media, software and systems integration markets. These latter services are treated as taxable at the standard-rate.

Whilst considering the acquisition of a new business, Sonaecom engaged the services of two separate firms of consultants which studied the market with a view to the possible acquisition of shares in the target business. Also, Sonaecom paid a taxable commission to an investment bank to organise, put together and guarantee the placement of a private issue of bonds. It claimed that it planned to use the capital obtained to acquire shares in the target business and then to provide taxable technical support and management services to that company.

The acquisition was subsequently aborted and Sonaecom made available the capital obtained through the issue of the bonds to the parent company of the group as a loan.

VAT was charged on the professional services and commission which Sonaecom sought to deduct.

The tax authorities denied the deduction on the grounds that, first, the acquisition of shares fell outside the scope of VAT and, second, the granting of credit was exempt from VAT.

Sonaecom challenged the decision, asserting that, by its nature, the acquisition at issue must at least be regarded as forming part of the costs which it had to incur to be able to properly supply the services which it regularly provides for its affiliates. Its interventions in the management of those companies are repeated and significant, in particular through cooperation in the development of their strategy and in the provision of services for remuneration and, in turn, it therefore frequently needs to procure a huge variety of supplies and services.

The CJEU noted that by its first question, the referring Court asks whether Article 4(1) and (2) and Article 17(1),(2) and (5) of the Sixth Directive must be interpreted as meaning that a holding company, whose involvement in the management of its subsidiaries is recurrent, is entitled to deduct the input VAT paid on the purchase of consultancy services relating to a market study carried out with a view to acquiring shares in another company, where that acquisition did not ultimately take place?

As a preliminary point, it noted that the VAT Directive, which entered into force on 1 January 2007, repealed the Sixth Directive without making material changes to that directive.

The CJEU considered that a company, whose sole object is to acquire shares in other companies without direct or indirect involvement in the management of those companies, neither has the status of taxable person within the meaning of Article 4 of the Sixth Directive nor the right to deduct tax under Article 17. However, this is not the case where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired, if that entails carrying out transactions which are subject to VAT, such as the supply of administrative, financial, commercial and technical services.

A mixed holding company is a company that, in addition to its non-economic holding activity, which consists in the holding of shares in other companies and is not subject to VAT, also carries out an economic activity. A mixed holding company which not only holds shares in companies, but also supplies remunerated, taxable services to some of those companies, is thus itself a taxable person, albeit entitled to only a pro rata deduction of input tax.

The CJEU also noted that since economic activities within the meaning of the Sixth Directive may consist of several consecutive transactions, preparatory acts must themselves also be treated as constituting an economic activity. Thus, any person with the intention, as confirmed by objective elements, of independently starting an economic activity, and who incurs the initial investment expenditure for those purposes must be regarded as a taxable person.

In the present case Sonaecom planned to provide to the target company, whose shares it wished to acquire, management services subject to VAT and, on that basis, to pursue an economic activity within the meaning of the Sixth Directive. Therefore, and to that extent, Sonaecom, as a mixed holding company, must, in principle, be considered a taxable person, within the meaning of the Sixth Directive; this is however for the referring court to determine.

As regards to the right to deduct, it follows from Article 17 that, in so far as the taxable person, acting as such at the time when he or she acquires goods or receives services, uses those goods or services for the purposes of his or her taxed transactions, he or she is entitled to deduct the VAT paid or payable in respect of those goods or services. That right to deduct arises at the time when the tax becomes chargeable, namely when the goods are delivered, or the services are performed.

The CJEU has previously held that the expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involves itself in their management and which, on that basis, carries out an economic activity must be regarded as belonging to its general costs and the VAT paid on that expenditure must, in principle, be deductible in full, unless certain output economic transactions are exempt from VAT.

The CJEU noted that in the present case it appears that the consultancy services were purchased in the context of Sonaecom's intended acquisition of shareholdings in a company and that it intended to carry out, for the benefit of that company, the economic activity of providing it with management services subject to VAT; again this is for the referring court to verify. Since the costs are part of Sonaecom's general costs in respect of the economic activity which it carries out in its capacity as a mixed holding company, that company enjoys, in principle, the right to deduct in full the VAT paid on those services. Also, the fact that, ultimately, the transaction did not materialise has no effect on the right to deduct VAT, which is retained.

The CJEU considered that if it should transpire that Sonaecom supplied services subject to VAT only to some of its subsidiaries, which it is for the referring court to verify, the VAT paid on the general costs would need to be apportioned in accordance with a method which it is for the Member State to determine.

On the second question, the CJEU noted that the referring court asks whether Article 4(1) and (2) and Article 17(1),(2) and (5) of the Sixth Directive must be interpreted as meaning that a mixed holding company, whose involvement in the management of its subsidiaries is recurrent, is entitled to deduct the input VAT paid on the commission paid to a credit institution for organising and putting together a bond loan intended for making investments in a given sector, where those investments did not ultimately take place and the capital obtained by means of that loan was paid in full to the parent company of the group in the form of a loan.

The CJEU suggested that it is necessary to determine whether, for the purposes of deducting input VAT paid on services, account is to be taken of the ‘intended use’ or ‘actual use’ made of those services by the taxable person.

Article 17(2)(a) provides that a taxable person is entitled to deduct input tax in so far as the goods and services ‘are used’ for the purposes of his or her taxable transactions. It follows from the wording of that provision that the right to deduct input tax is founded on an approach which is principally based on the actual use of the goods and services. Consequently, an actual use of goods and services takes precedence over the initial intention.

The CJEU noted that in the present case Sonaecom paid VAT on commission for organising and putting together a bond loan in order to finance its investments. As those proposed investments did not materialise, Sonaecom chose to make that amount available to its parent company in the form of a loan. Since that loan transaction, which represents the actual use made of the services, is among the transactions exempted under Article 13B(d)(1) of the Sixth Directive, Sonaecom cannot be entitled, under Article 17, to deduct attributable VAT.

In conclusion – a holding company has the right to deduction in respect of expenditure for the acquisition of shares in a company to which it intended to supply taxable services, including where that acquisition did not ultimately take place, however an actual exempt transfer of capital raised precludes a deduction on associated costs. The direct link with the exempt service provided takes precedence over the original intention to supply taxable services.

Comments: Confirmation that recovery of VAT on costs incurred in preparation for an acquisition of a Target Co, where there was a documented intent to provide post acquisition taxable supplies, is welcome and in line with current UK market practice.

The change of use of the bond issue, from funding the acquisition to a (VAT exempt) loan to the parent company, over-rides the original intention, and a direct and immediate link to an exempt supply was established. There may have been scope to challenge whether VAT should have been originally charged by the investment bank on its services, so a useful reminder that it is always worth reviewing whether VAT should apply to transaction fees.